No. 11548

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

STIMSON MILL COMPANY,
Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

Reply Brief for Petitioner.

BERT L. KLOOSTER,
111 West Monroe Street,
Chicago 3, Illinois.

CHAPMAN AND CUTLER,
111 West Monroe Street,
Chicago 3, Illinois.
Of counsel

Scheffer Printing Company, Del. 7171

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REPLY BRIEF FOR PETITIONER.

The respondent's brief is not responsive to the one essential issue (Br. Pet. pp. 56-58) on which his entire position depends with respect to the jurisdiction of this Court.

I. The determination of "a fair and just amount" representing normal earnings cannot include the computation of a constructive average base period net income.

The respondent fails to demonstrate how the "fair and just amount" can represent a constructive average when the statute provides for "a fair and just amount *representing normal earnings.*" He states the question obscurely (Br. Resp. pp. 10, 12) and answers it obscurely as a "basic reason" (Id. pp. 29, 28, 30).

While the respondent has final discretion to determine normal earnings (just as this Court properly held respect-

ing his discretion under section 721 to determine abnormal income attributable to other years, *James F. Waters, Inc.* v. *Commissioner,* March 19, 1947— C. C. H. 1947 par. 9196), *it is plain that if the determination of normal earnings under section* 722 *does not include the computation of the "average," such computation is only a ministerial duty involving no "determination" the review of which is precluded by section* 732(c).

A) Respondent avoids the common meaning of the statutory provision.

The jurisdiction question raised by the respondent, and the question respecting the proper "average," are not abstruse or difficult. Both can be answered in terms easily understood.

Assume that in connection with other computations a mathematical problem states: "Here are four figures to be used as an average."

Anyone, of course, would total the four figures, divide by four, and use the resulting "average" in making the further computations required in the problem.

If the problem involved the excess profits tax, and stated: "Here are four figures to be used as an 'average base period net income,'" then obviously one must look to the definition of "average base period net income" in order to use the four figures.

The latter essentially is the statutory provision of section 722(a), normal earnings for four years being used to compute the statutory "average" (such normal earnings being stipulated (Tr. pp. 16, 17) and involving no issue in the case at bar).

The same concept is indicated by section 713(e) (1): if earnings for one year are less than 75% of the average

of earnings for the other three years of the base period, "the amount *used* for such one year" shall be such 75%.

It is obvious that the normal earnings which are used as an average, are not themselves the average.

B) Statutory terms, and their equivalents, are not employed by respondent with their proper meaning.

By inference respondent creates the illusion that section 722 is independent of subchapter E (Br. Resp. pp. 9, 13, 14, 17) and at one point argues that section 722 is "totally independent of Section 713(e)(1)" (Br. Resp. p. 25). In fact section 722 is a subordinate provision of Subchapter E (Br. Pet. pp. 47, 48) and is dependent on section 713 and its subsections for connecting section 722 with the provisions which spell out the computation of the tax (Br. Pet. pp. 25-31).

Since section 722 is not an independent provision (as was the 1918 relief provision, Br. Pet. pp. 79, 80), the decisions cited by respondent (Br. Resp. p. 15) relating to the 1918 provision, have no bearing on the tax computation which is in issue here. Such decisions are applicable to the point on which this Court cited them in the *Waters* case, *supra,* namely, the respondent's final discretion to determine abnormal income attributable to other years (which is analogous to his final discretion to determine normal earnings) but those decisions are not applicable to the computation of the average, the ministerial act by which such earnings are to be used for the computation of the excess profits tax.

Normal Earnings.

In his "basic reason" sentence (Br. Resp. p. 29) respondent argues that Section 713(e)(1) is not "a factor in the reconstruction of taxpayer's base period net income under

Section 722." If he means that it is not a factor in determining normal earnings he is in agreement with petitioner, that the normal earnings are not the average. But the over-all inference seems to be to the contrary.

Respondent further argues that since the amount of the section 713(e)(1) adjustment "does not represent the taxpayer's normal earnings, it may obviously not be used as a basis for Section 722 relief" (Br. Resp. p. 31). Again the words are in agreement with this point I since the respondent can give relief under section 722 only by determining "normal earnings," but when the context is considered the inference is to the contrary.

In view of the inferences just mentioned, as well as the confusing use of terms in other respects in the Brief for Respondent, petitioner replies further by showing the statutory meaning of "Normal earnings" and terms used in connection therewith. "Normal earnings" are not an average (See Definition, Appendix H). A correction of earnings "in one or more taxable years in the base period," as provided in section 722(b)(1), because of a strike or other abnormal event, restores the earnings for each year to the level they would normally or naturally have reached under the economic conditions which obtained generally for such year. The effect of determining "normal earnings" is to *"attribute to the taxpayer in such an event* (e.g. a strike) *the earnings it would normally have experienced had such event not occurred"* (Br. Pet. p. 15a, Committee on Ways and Means, House Report No. 146, 77th Congress, 1st Session, C. B. 1941-1, p. 551). (Emphasis throughout this Reply Brief is supplied by Petitioner).

Thus "normal earnings" for the depression year of 1938 are never raised by section 722 above the depressed level which would have been experienced in the absence of a recognized abnormality (Br. Pet. pp. 43-46). Thus, also, in

the case at bar the correction of earnings for 1937 *results only in the "normal earnings" that would naturally have been experienced if there had been no strike in that year.*

Section 722(b)(2) (Br. Resp. p. 19) corrects only temporary and unusual conditions "in the case of such taxpayer" or its industry, but does not correct the general business depression (Br. Pet. pp. 44, 45, and Bulletin on Section 722, p. 19). Neither is the general business depression corrected under Section 722 (b) (3) which merely brings a low industry business cycle into conformity with the general business cycle, thus leaving the year 1938 at the low level of general business (Bulletin on Section 722, pp. 20, 21, 28, 31, 35, 36—Appendix I).

Average Base Period Net Income.

On the other hand, "average base period net income" is purely a statutory concept for computing excess profits tax liability. It is not a "norm" (Br. Resp. p. 9). The statute uses it as a synonym for "standard of normal earnings," (section 722(b)) and so does Section 7 of E. P. C. 13 (Appendix G). It measures earnings for 1942 which are *not* subject to the tax. The "excess profits net income" specified in section 713, is made "normal" by correcting certain abnormalities under section 711 (b) (1) before such earnings are used for the "average" under section 713 (Br. Pet. pp. 46, 47). The "normal earnings" of section 722(a) are to be used as provided by the definition of "average base period net income" which requires the use of income "for each of the taxable years of the base period."

Purpose of Congress.

The same ambiguous use of words by the respondent (as mentioned under "normal earnings" supra) appears with

respect to the intent of Congress (Br. Resp. pp. 11, 26, 28). If respondent means to argue that Congress intended that "normal earnings" are not the statutory "average," then petitioner's point I is admitted and no further reply is necessary. Respondent, however, infers that the intention of Congress was contrary to this point I and therefore petitioner replies further.

The Committee on Ways and Means "and the Congress, in formulating and enacting that legislation, exercised caution both with respect to *the methods provided for measuring the portion of the corporate earnings to be subjected to the tax* and in alleviating the specific hardships which were disclosed" (Br. Pet. p. 14a, House Report No. 146, 77th Congress, 1st Session, C. B. 1941-1, p. 550).

Thus the "average base period net income" of Section 713, was one of "the methods provided for measuring the portion of the corporate earnings to be subjected to the tax." The general purpose to correct abnormalities in earnings so that they are "normal," before such earnings are used for the statutory average, is shown by Sections 711(b)(1) and 713(c) (Br. Pet. p. 46), and also by the provisions which allow specific relief in addition to the reconstruction of normal earnings (Br. Pet. 47).

When the present general relief provisions were adopted in 1942, Congress reiterated *the same purpose which had motivated the enactment of the 1941 provision,* to use only normal earnings for the computation of the statutory "average" and the credit based on income: "that equitable considerations demand that every reasonable precaution should be taken to prevent unfair application of the excess-profits tax in abnormal cases," and to see that *"income subject to the tax is clearly of the type intended to be reached"* (Br. Pet. pp. 21a, 22a, Committee on Ways and Means,

House Report No. 2333, 77th Congress, 1st Session, C. B. 1942-2, p. 390).

The 1941 enactment of Section 722 by a reference to Section 713 (d) had provided that the reconstructed normal earnings were to be used to compute the statutory average. That reference was no longer necessary in the 1942 enactment since Section 722 now states that taxpayers are "entitled to use" Section 713 without excepting any subsections (Br. Pet. pp. 36, 37). The statute thus confirms the purpose shown by the Committee Reports. The same purpose is further shown because the statute allows relief to a taxpayer "if its *average base period net income* is an inadequate *standard of normal earnings* because—(1) in one or more taxable years in the base period normal . . . operation was interrupted or diminished" (Section 722 (b) (1)).

Correction of Earnings for 1938.

Respondent infers that it is improper for petitioner to seek an adjustment for the year 1938 under section 713(e) after the reconstruction of normal earnings for the year 1937 (Br. Resp. p. 20). In reply an explanation is therefore necessary.

The "standard of normal earnings" prescribed by section 713 (e) is *required* to be used by taxpayers whose base period earnings are *normal* and need no correction under section 722. The statute does *not* provide that it must be "claimed and . . . allowed" (Br. Resp. pp. 9, 16); it is not a mere "possible adjustment" (Id. p. 13) that "so happens" (Id. p. 29). Under section 713 (e) *low normal earnings* for the depression year of 1938 are *required* to be raised to 75% of the average for the other three years for computing the portion of earnings which are not subject to tax liability.

Thus in the case at bar if petitioner had not had a strike in 1937 its earnings for that year would have been normal and the required 75% rule would have operated to give petitioner an average base period net income of $89,539.31. But, because of the strike in 1937, the earnings of petitioner for that year, and also the correction for the depression year of 1938 under the 75% rule, were too low, and in the language of Section 722 (b) "its *average base period net income* is an inadequate *standard of normal earnings.*" The correction for the strike in 1937 reconstructs the "normal earnings" for that year, but unless such "normal earnings" are used as an "average base period net income" there will not be a proper correction of the figure used for 1938. By using *reconstructed* "normal earnings" for 1937, the 75% rule automatically operates to provide a proper correction for 1938, in the same manner as it does for other taxpayers having "normal earnings," and gives petitioner a "standard of normal earnings" amounting to $89,539.31, the same amount as would have resulted if petitioner had had no strike in 1937.

Fair and just amount.

If in the "basic reason" sentence (Br. Resp. p. 29) respondent means to argue that since the words, "fair and just amount," are in the singular number, that "amount" represents a "constructive average base period net income," that argument is contrary to the statutory provision for "a fair and just amount representing normal earnings."

Since the statute requires a separate determination of normal earnings for each year of the base period, and since as a practical matter normal earnings must be determined separately by years (Br. Pet. pp. 44, 45, and E. P. C. 13, Sec. 7, par. (a), Appendix G) the statute clearly provides

"a fair and just amount representing normal earnings" *in each of the years in the base period* (See Title 1, U.S. C., Sec. 1, which provides that "words importing the singular number may extend . . . to several persons or things").

In obscurely arguing that the "average" pursuant to section 713 (e) is not a "fair and just amount," (Br. Resp. p. 11), respondent infers that such average is not just or fair. Since, however, it is the required standard for the tax computation, its fairness is not subject to question here any more than the fairness of the excess profits tax. Petitioner, however, has already made an alternative argument on this point (Br. Pet. pp. 64-68).

Comparison.

In the "basic reason" sentence (Br. Resp. pp. 29, 30, 33) respondent argues that there must be a "comparison between what would be regarded as normal earnings in the base period, as constructed under Section 722 (b) (1), and the actual earnings *in that period.*" This statement is directly contrary to the statutory language of Section 722 (a) providing for a "constructive average base period net income for the purposes of an excess profits tax based upon *a comparison* of normal earnings and earnings *during an excess profits tax period.*" *An excess profits tax period includes the year* 1942 *but not the years of the base period.* Section 713 also makes such a comparison in Section 722(a) by using normal earnings as an "average base period net income." (The respondent's "comparison" argument is answered in Brief for Petitioner, pages 52-56).

Regulations.

Respondent argues that the regulations are reasonable (Br. Resp. p. 11) but offers nothing to substantiate his point other than a vague reference to the statute (Br. Resp.

p. 28) and the opinion of the Tax Court herein which petitioner has shown to be erroneous (Br. Pet. pp. 70, 71).

Petitioner calls the Court's attention to the fact that the original Regulations 112, Section 35, 722(b) (1) (Br. Pet. p. 61), which section had been amended to read as shown at page 57 of Brief for Petitioner, has been amended again while briefs were being prepared in this case, by T. D. 5560, April 16, 1947, to cause the last sentence thereof to read as follows:

> "In a proper case, however, growth may be recognized in arriving at the fair and just amount representing normal earnings if, and to the extent that, such recognition is reasonable and consistent with the conditions and limitations of section 722."

In reality the granting of relief under section 722 has been completed in the case at bar by the determination of constructive normal earnings for 1937, and the determination that earnings are normal for 1936, 1938 and 1939 (Tr. pp. 16, 17), and there is no issue herein respecting the granting of such relief. The ministerial duty to compute the "average" under section 722 is obviously not part of the discretionary duty to determine "normal earnings."

II. Judicial review of a purported computation of the average under section 722 which is contrary to statutory authority, is not precluded by section 732(c).

This proposition follows as a necessary result of the conclusions reached in point I, even though the average be considered to be computed under section 722.

The respondent (Br. Resp. p. 23) cites *Riverside Oil* Co. v. *Hitchcock,* 1903, 190 U. S. 316, 324, 325, 47 L. ed. 1074, 1078, holding: "The court has no general supervisory power over the officers of the Land Department, by which

to control their decisions upon questions *within their jurisdiction.*" But respondent has issued regulations and made purported determinations which reach beyond his jurisdiction under Section 722, and he now asks this Court to close its eyes to such usurpations on the ground that whatever he assumes power to do under that section should not be investigated (Br. Resp. p. 25).

> "No doubt it is true that this court cannot displace the judgment of the board in any matter within its jurisdiction, but it is equally true that the board cannot enlarge the powers given to it by statute and cover a usurpation by calling it a decision on purity, quality, or fitness for consumption." *Waite* v. *Macy,* 1918, 246 U. S. 606, 608, 609, 62 L. ed. 892, 894.
>
> ". . . but the determination in this case goes so far beyond any possible proper application of the word as to defeat its meaning and to constitute an attempt arbitrarily to disregard the statutory mandate. The rule therefore—that where the adoption of one of several possible interpretations of a doubtful statute involves the exercise of judgment and discretion, upon which the duty of an officer to perform a particular act depends, the courts cannot control the exercise of that discretion—has no application in the present case." *Lukens Steel Co.* v. *Perkins,* 1939, C.C.A. Dist. of Col., 107 F. 2d 627, 630.

The applicable principles are in consonance with recent pronouncements of the Supreme Court of the United States. In *Hirabayashi* v. *United States,* 1943, 320 U. S. 81, 104, 87 L. ed. 1774, 1788, the Supreme Court (affirming a decision of this Court) said:

> "The essentials of the legislative function are preserved when Congress authorizes a statutory command to become operative, upon ascertainment of a basic conclusion of fact by a designated representative of the Government. Cf. The *Aurora* v. *United States,* 7 Cranch (U.S.) 382, 3 L. ed. 378; *United States* v. *Chemical Foundation,* 272 U.S. 1, 12, 71 L. ed. 131, 141."

The same principles respecting the delegation of discretionary authority to administrative officers, were reiterated and applied in *Yakus* v. *United States*, 1944, 321 U. S. 414, 424, 425; 88 L. ed. 834, 848; *Bowles* v. *Willingham*, 1944, 321 U. S. 515; 88 L. ed. 903, 904; and *Opp Cotton Mills* v. *Administrator*, 1941, 312 U.S. 126, 145, 85 L. ed. 624, 636.

In the case at bar the basic conclusions of fact to be ascertained are the normal earnings represented by a fair and just amount for each year of the base period. *The computation of the average is not an ascertainment of a basic conclusion of fact.* Upon ascertainment of the normal earnings, the statutory command which becomes operative is that such normal earnings are to be used—not as an average—but as an average base period net income.

Respondent's contention (Br. Resp. p. 23) that "if, as the taxpayer contends (Br. Pet. pp. 75-77), the function of the Commissioner in the circumstances here has been reduced to the performance of a mere ministerial duty, concerning which no determination by him was necessary, it is apparent that the taxpayer's remedy is mandamus to compel the Commissioner to perform such duty," makes the unsupported assumption that a ministerial duty is recognizable only in an action of mandamus.

In numerous cases the Circuit Courts of Appeals have considered and decided cases appealed from the Tax Court under Section 1141 where *a question of statutory computation* was involved. In such cases taxpayers might also have had a remedy by mandamus to compel performance of a purely ministerial duty by the Commissioner. But a concurrent remedy by mandamus has never affected, and cannot affect, the jurisdiction clearly given by Section 1141 to the Circuit Courts of Appeals "to review the decisions of the Board."

A statutory computation such as is involved here, may

be reviewed under Section 1141 without considering whether or not it is properly classified as a ministerial duty. The fact in this case that the computation is a purely ministerial duty is significant only for the purpose of showing that the Commissioner can make no "determination" with respect thereto, the review of which is precluded by Section 732(c) (Br. Pet. pp. 75-77).

Although the quoted statement (Br. Resp. pp. 23, 10) does not deny that the computation of the average is only a purely ministerial duty, we reply to the contrary inference. The computation of the required average in accordance with the statutory definition is clearly a ministerial duty, to the same extent as the computation of interest (*Blair, Commissioner,* v. *Birkenstock,* 1925, C.C.A. Dist. of Col., 6 F. 2d 679, 681) or the allowance of a credit (*Blair, Commissioner* v. *Union Pac. R. Co.,* 1925, C.C.A. Dist. of Col., 6 F. 2d 484, 486; *Kendall* v. *Stokes,* 1838, 12 Peters (37 U.S.) 524, 614, 9 L. ed. 1181, 1216) or the recomputation of a pension at a higher rate in accordance with statutory provisions (*Miller* v. *Black,* 1888, 128 U.S. 40, 52, 32 L. ed. 354, 358).

When an administrative officer has completed the discretionary determination entrusted to him, the remaining duty to carry that determination into effect is purely ministerial. Thus in *United States* v. *Hines,* 1939, C.C.A. Dist. of Col., 103 F. 2d 737, 745, the Court said:

> "The administrator found as a fact that the insured at the time he made the application for reinstatement was in as good health as he was at the due date of the premium in default. . . . Thus the Administrator, having fully exercised his discretion in this respect, and having found that the veteran met the standard required by law, there remains no further discretion to be exercised. There only remains a purely ministerial duty of the Administrator. . ."

Similarly in *Butterworth* v. *Hoe,* 1884, 112 U. S. 50, 68, 28 L. ed. 656, 662, the Supreme Court said:

> "He (the Commissioner of Patents) had fully exercised his judgment and discretion when he decided that the relators were entitled to a patent. The duty to prepare it, to lay it before the Secretary for his signature and to countersign it, were all that remained and they were all purely ministerial."

The ministerial duty prescribed by section 722 does not bestow any power to adjudge, decide or determine (Br. Pet. pp. 75, 76) and there can be no "determination" with respect thereto. Likewise a pretended discretionary determination beyond and outside of the bounds of section 722 is an attempt to adjudge without jurisdiction, and is not a discretionary determination, or any kind of determination whatever. Therefore, an assumed determination which is either contrary to the prescribed ministerial duty, or in defiance of statutory limits of discretion, is not a "determination" under section 722, the review of which is precluded by section 732 (c).

III. The rights which petitioner asserts relate to section 713, the review of which is not precluded by section 732(c).

The respondent does not deny, and cannot deny, that the computation of the "constructive average base period net income" is part of the computation of the excess profits credit (Tr. 27).

May the Commissioner *disallow* the use of the statutory standard of normal earnings *required for that credit* in Section 713(e)?

May the Commissioner *invent* a lower standard? May the Commissioner thereby *arbitrarily increase the excess profits tax* above the tax payable pursuant to the computation required by law? Petitioner respectfully submits that

a proper construction of Section 713 requires a negative answer to all of these questions, the review of none of which is precluded by section 732 (c).

IV. The Tax Court had jurisdiction of the proceeding.

Respondent argues that section 722 (d) prohibits the application of section 722 and cites several cases which are not applicable to the proceedings in this case.

Section 732(a)

The Tax Court has jurisdiction in this case under section 732 (a). The Commissioner on December 26, 1944, sent the petitioner a notice of disallowance of its application for relief (Tr. p. 7) and within 90 days, on March 24, 1945, a petition for review was filed with the Tax Court (Tr. pp. 1, 12). Nothing else is required by that section to give the Tax Court jurisdiction.

Section 722(d)

Respondent argues that section 722 (d) is involved in determining jurisdiction of the Tax Court. He cites the cases of *Uni-Term Stevedoring Co., Inc.*, v. *Commissioner*, 3 T. C. 917, and *American Coast Line, Inc.*, v. *Commissioner*, C. C. A. 2, 159 F. 2d 665 (on appeal from 6 T. C. 67) which may be considered together. In both cases the Commissioner had not acted on the merits of applications for relief and *had sent no notice of disallowance* whereby the Tax Court could take jurisdiction under section 732 (a).

Both cases involved section 722 (d) before its amendment to its present language. This section formerly allowed an application for relief to be filed directly with the Tax Court in the case of a deficiency. Such was the provision of section 722 (e) enacted by section 6 of the Excess

Profits Tax Amendments of 1941 (26 U. S. C. A., Internal Revenue Acts Beginning 1940, p. 84), which was changed in wording and renumbered section 722 (d) by section 222 of the Revenue Act of 1942 (26 U.S.C.A., Internal Revenue Acts Beginning 1940, p. 299, furnished herewith as Appendix K-2). The privilege of filing an application directly with the Tax Court in the case of a deficiency, was taken away by Act of December 17, 1943, C. 346, 57 Stat. 601 (Id, p. 417) which enacted the present section 722 (d) (Exhibit K-2) applicable beginning after December 31, 1939.

In the above two cases no excess profits tax had been paid. The Tax Court lost jurisdiction in the American Coast Line case after section 722 (d) was amended December 17, 1943.

Ceco Steel Products Corp. v. *Commissioner,* C.C.A. 8, 150 Fed. (2d) 698, and *Pioneer Parachute Company, Inc.* v. *Commissioner,* may also be considered together. In both cases applications had been filed directly with the Tax Court which lost jurisdiction upon amendment of section 722 (d). In both cases the Commissioner had not considered the merits of the application and *had sent no notice of disallowance* to give the Tax Court jurisdiction under section 732 (a).

In *Blum Folding Paper Box Co.* v. *Commissioner,* 4 T. C. 795, the application covered excess profits tax paid. ~~The disallowance was not~~ This case was dismissed on the merits since the taxpayer failed to supply supporting evidence to the Commissioner, and ~~The Tax Court refused to consider the evidence before it had been considered by the Commissioner and disclaimed jurisdiction because original action by that court would not be a review of the Commissioner's determination.~~ the facts stated in the claim were not adequate for relief.

In *Pohatcong Hosiery Mills, Inc.* v. *Commissioner,* C. C. A. 3, May 23, 1947, — F. 2d —, the Commissioner notified the taxpayer that its applications were prematurely filed,

that they did not constitute claims for refund because the tax had not been paid, and that such notice was not a notice of disallowance. Since there was *no notice of disallowance,* the Tax Court could not take jurisdiction.

In the case at bar the situation is quite different. Here the respondent acted on the merits of the application and sent petitioner a notice of disallowance. While the case was pending in the Tax Court he granted relief for 1937 and found that income of other base period years was normal (Tr. pp. 24, 25). He further stipulated (Tr. p. 19) that if the average is computed as the petitioner contends "the petitioner has overpaid its excess profits tax for said year (1942) in an amount to be determined in accordance with a recomputation of liability under Rule 50 of The Tax Court's Rules of Practice."

There are two reasons why the above cases involving section 722 (d) have no bearing on the situation here presented:

(1.) After the 1943 amendment of section 722 (d), the only requisites for jurisdiction of the Tax Court are the notice of disallowance and the timely petition to the Tax Court. "Such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayment." (section 732 (a)—Appendix K-1). In the case of a notice of deficiency, only the notice and timely appeal are requisite to jurisdiction. The similarity of language of section 732 (a) to section 272 (a) shows that nothing more was intended for jurisdiction to review applications for relief. The Tax Court did not consider more than these two requisites for jurisdiction in *Lamar Creamery Co., Inc.,* v. *Commissioner,* 1947, 8 T. C. ....., No. 107.

(2.) Procedural questions relating to the sufficiency of

the application for relief as a claim for refund, should have been raised by the Commissioner in the Tax Court. His action on the merits was a waiver of any irregularities (*Tucker* v. *Alexander,* 1927, 275 U. S. 228, 231, 72 L. ed. 253, 256), and was presumptive proof of all acts necessary to make that action legally operative (*R. H. Stearns Co.* v. *United States,* 1934, 291 U. S. 54, 63, 78 L. ed. 647, 653). If he had found that payment had not been made before the claim was filed, he would have sent petitioner the type of notice he sent in *Pohatcong Hosiery Mills, Inc.,* supra. Instead, the Commissioner sent a notice of disallowance of the claim and thus determined that the claim had met the requirements of section 722 (d). The Commissioner failed to raise any objection in the Tax Court. In the Tax Court he did not deny that his determination was correct. *No other tribunal can review that determination.* Review in this Court and elsewhere is prohibited by section 732 (c).

The Commissioner stipulated that the tax was overpaid, if the average is computed as petitioner claims it should be, and the Tax Court adopted the stipulation as a finding of fact (Tr. p. 27). It was a finding that the petitioner would recover something—that the claim met the requirements of section 722 (d)—a determination that the tax had been paid before the claim was filed. It was a determination of a question of fact necessary solely by reason of section 722, of which section 722 (d) is a part. It was not a question of law involving a ministerial duty, as is the computation of the "average." Review of such a fact determination in this Court is precluded by section 732 (c).

The record shows that the amount of the deficiency, $2,106.08, was paid after the application for relief was filed. *Some tax had been paid,* and that was the only requirement as a basis for relief (*Uni-Term Stevedoring Co.* v. *Commissioner,* 3 T. C. 917, 919). Regulations 112, Sec.

35.722-5(c) provides: "The amount of credit or refund claimed shall be the excess of the amount of excess profits tax for the taxable year paid over the amount of excess profits tax claimed to be payable computed pursuant to the provisions of section 722." From the record the amount of overpayment can be computed as $5,759.70 subject to adjustment for the 10% post-war credit (Br. Pet. p. 15), and therefore from any standpoint an overpayment of approximately $3,000 results even though the amount of the deficiency be excluded from the computation.

The Tax Court, therefore, clearly had jurisdiction under section 732 (a).

Section 272(a)

Respondent (Br. Resp. p. 2, footnote) also attacks the jurisdiction of the Tax Court under section 272(a) (Appendix L). Regardless of dictum in various cases to the contrary, petitioner submits that the Tax Court also had jurisdiction under section 272(a). The timely appeal from a notice of deficiency is clear (Tr. pp. 3, 4). Nothing else was required for jurisdiction. The agreement of the parties could neither give jurisdiction, nor change it to some other section (Cf. *Mitchell* v. *Maurer,* 1934, 293 U. S. 237, 244, 79 L. ed. 338, 343). It remained pursuant to section 272(a). Findings of overpayments and refunds were therefore prohibited unless found by the Tax Court in that proceeding, as provided by section 322(c) and (d) (Appendix M). Cf. *De Sabichi* v. *Commissioner,* 1926, 4 B. T. A. 445, 447.

Any question as to whether in connection with the filing of the application for relief, all requisite steps were taken for the allowance of a refund, is not a jurisdictional question under section 272(a).

The Tax Court therefore also had jurisdiction of this case pursuant to sections 272(a) and 322(c) and (d).

Conclusion.

In view of the foregoing and in view of the reasons presented in the Brief for Petitioner, it is submitted that the decision of the Tax Court should be reversed with directions to compute the constructive average base period net income in the manner provided by section 713(e) of the Internal Revenue Code.

Respectfully submitted,

Bert L. Klooster,
111 West Monroe Street,
Chicago, Illinois.

Chapman and Cutler,
111 West Monroe Street,
Chicago, Illinois,
Of Counsel.

June, 1947.

APPENDIX G.

Excerpts from E. P. C. 13, issued by the Excess Profits Tax Council, April 9, 1947, and published in Internal Revenue Bulletin No. 9, for May 5, 1947, pp. 18-23.

The recognition of fluctuation, abnormal variation, and growth in the determination of constructive average base period net income.

* * * *

5. As used in this connection:

(a) *Fluctuation* refers to variations, in the income, expense, or net earnings experience of a business or industry, of a character or magnitude which ordinarily would be expected to occur within the interval selected as the base period.

* * * *

7. *Fluctuation cases.*—By definition, the recognition of fluctuation precludes the application of methods whereby greater weight is given to experience during one part of the base period than to the experience during another. The objective is the selection of a method which will give recognition to the ordinary fluctuation which would be expected to characterize the taxpayer's experience during the base period. Accordingly, in converting constructive annual earnings for the several base period years (or for one year when appropriate) to constructive average base period net income, the following methods will be acceptable:

(a) When earnings for each year of the base period have been constructively determined, the standard of normal earnings should be determined by the use of the arithmetic average of such earnings.

* * * *

9. *Growth cases.*—The objective of methods recognizing growth is to correct the taxpayer's experience for the effects of changes during the base period in business conditions or in the character of the taxpayer's business activities which, by the end of the base period, resulted in a relatively permanent increase in the taxpayer's level of earnings.

* * * *

(c) When the comparative experience or the index, used in reconstructing the three earlier base period years, itself typifies growing business experience, correction for the growth factor will not be fully completed in the yearly reconstruction. In such cases, full recognition of growth may be accomplished by determining the taxpayer's normal earnings level through the use of any accepted statistical method including the growth formula. The amount so determined shall, in no case, be greater than the highest amount of constructive earnings for any year of the base period.

* * *

CHARLES D. HAMEL,
Chairman, Excess Profits Tax Council.

April 9, 1947.

APPENDIX H.

Definition of "Normal".

(Webster's New International Dictionary,
Second Edition, Unabridged.)

Normal * * *

2. According to, constituting, or not deviating from, an established norm, rule, or principle; conformed to a

type, standard, or regular form; performing the proper functions; not abnormal; regular; natural; analogical.

* * * *

5. *Econ.* Pertaining or conforming to a more or less permanent standard, deviations from which, on either side, on the part of the individual phenomena are to be regarded as self-corrective. Thus, the *normal price* is a price which corresponds to the cost of production. In economics, *natural* and *normal* are sometimes used as synonymous; but *natural* involves certain assumptions not connoted by *normal.*

* * * *

Syn. and Ant.—See Regular.

Regular * * *

Syn.— . . . Regular, Normal, Typical. That is *regular* (opposed to irregular), as here compared, which conforms to an established or prescribed rule or standard; *normal* (opposed to abnormal) is more limited and exact in its application, and implies strict accordance with what is to be expected if regular processes are followed or proper functions performed; as, to apply the *regular* tests, his actions are not those of a wholly *normal* person; a *regular* verb; his temperature is *normal.*

APPENDIX I.

Excerpts from
Bulletin on Section 722 of the
Internal Revenue Code
November 1944
Washington, D. C.

PART IV.

Variant Profits Cycle and Sporadic Profits Experience.

* * * *

Page 20.

Under section 722(b)(3)(A) the taxpayer must demonstrate that the industry of which it is a member normally experiences a cyclical pattern of profits of such a character that the average profits realized by the industry during the statutory base period differed markedly from the profits experience of business generally, and therefore is not a fair representation of the taxpayer's normal profits. Under section 722 (b)(3)(B), the taxpayer must show that its industry characteristically has a profits behavior involving isolated periods of high production and profits occurring at irregular intervals, and that such periods were not represented, or were inadequately represented, in the statutory base period. Inadequate representation of such periods occurs when either their frequency or extent during the base period was less than is, on the average, normally encountered.

* * * *

Page 21.

The manner in which *prior experience should be used as a guide* in the determination of normal earnings in a section 722(b)(3) case will be discussed below in the sections on reconstruction.

* * * *

Page 27.

(C) Variant Profits Cycle-Reconstruction.

* * * *

Page 28.

Wherever in the following description reference is made to average base period net income the term means the simple arithmetic average of the annual incomes, deficits

included, rather than the statutory average base period net income as defined in section 713, which may reflect the application of the growth formula, deficit rule, or 75 per cent rule.

* * * *

Page 31.

(8) The final step in reconstruction is to adjust the average base period net income of the taxpayer to the normal base period level by applying the ratio found in step (7), which ratio represents the degree of the taxpayer's cyclical depression.

* * * *

Page 35.

(E) Sporadic Profits Experience-Reconstruction.

(1) Having determined that the taxpayer has met the test of demonstrating that its production and profits experience, together with that of its industry, is characterized by sporadic and intermittent periods of high production and profits, the next step is to determine whether such periods are inadequately represented in the base period years, and, if so, to reconstruct the normal earnings of the taxpayer. The computation to determine the constructive average base period net income will answer both of these requirements.

Having determined the length of the extended period to be considered, as discussed above, there are at least two methods for computing the constructive average base period net income. Wherever in the following discussions reference is made to average base period net income, the term means the simple arithmetic average of the annual incomes, deficits included, rather than the statutory average base period net income as defined in section 713, which

may reflect the application of the growth formula, deficit rule, or 75 per cent rule.

(2) The first method, as suggested by the regulations, is to proceed exactly as in the case of a variant profits cycle case as discussed in section (C) herein. Since the essential nature of the depression of the base period net income is the same in both cases, namely, that the base period is unrepresentative of the normal experience of the taxpayer, the reconstruction can proceed along similar lines.

APPENDIX K-1.

Section 732(a) Internal Revenue Code (26 U.S.C.A. 1945 ed. section 732(a))

Review of abnormalities by Board of Tax Appeals—(a) Petition to the Board

If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711(b) (1) (H), (I), (J), or (K), section 721, or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayment.

APPENDIX K-2.

Former Provision of Section 722(d)
Section 722(d)—as amended by Section 222 of the Revenue Act of 1942
(26 U.S.C.A. Internal Revenue Acts Beginning 1940, pp. 299, 300)

"(d) Application for relief under this section. The taxpayer shall compute its tax, file its return, and pay its tax under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer, not later than six months after the date prescribed by law for the filing of its return, or if the application relates to a taxable year beginning after December 31, 1939, but not beginning after December 31, 1941, within six months after the date of the enactment of the Revenue Act of 1942, makes application therefor in accordance with regulations to be prescribed by the Commissioner with the approval of the Secretary, except that if the Commissioner in the case of any taxpayer with respect to the tax liability of any taxable year—

> "(1) issues a preliminary notice proposing a deficiency in the tax imposed by this subchapter such taxpayer may, within ninety days after the date of such notice make such application, or
>
> "(2) mails a notice of deficiency (A) without having previously issued a preliminary notice thereof or (B) within ninety days after the date of such preliminary notice, such taxpayer may claim the benefits of this section in its petition to the Board or in an amended petition in accordance with the rules of the Board.

If the application is not filed within six months after the date prescribed by law for the filing of the return, or if

the application relates to a taxable year beginning after December 31, 1939, but not beginning after December 31, 1941, within six months after the date of the enactment of the Revenue Act of 1942, the operation of this section shall not reduce the tax otherwise determined under this subchapter by an amount in excess of the amount of the deficiency finally determined under this subchapter without the application of this section. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

Present Provision of Section 722(d)
As amended by Act of December 17, 1943, C. 346, 57 Stat. 601 (26 U.S.C.A. 1945 ed. Sec. 722(d))
(26 U.S.C.A. Internal Revenue Acts Beginning 1940, p. 417)

(a) Section 722 (d) of the Internal Revenue Code (prescribing the time for filing applications for general relief under the excess-profits tax) is amended to read as follows:

"(d) Application for Relief Under This Section. The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the

Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year."

(b) The amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1939.

APPENDIX L.

Excerpts from Section 272 Internal Revenue Code (26 U.S.C.A. 1945 Edition Sec. 272(a)(1))

(a) (1) Petition to Board of Tax Appeals. If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. . . .

(d) Waiver of restrictions. The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subsection (a) of this section on the assessment and collection of the whole or any part of the deficiency.

APPENDIX M.

Excerpts from Section 322 Internal Revenue Code (26 U.S.C.A. 1945 Edition Sec. 322)

(a) Authorization

(1) Overpayment. Where there has been an overpayment of any tax imposed by this chapter, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

* * * *

(b) Limitation on allowance

(1) Period of limitation. Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * * *

(c) Effect of petition to Board. If the Commissioner

has mailed to the taxpayer a notice of deficiency under section 272(a) and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except—

(1) As to overpayments determined by a decision of the Board which has become final; and

(2) As to any amount collected in excess of an amount computed in accordance with the decision of the Board which has become final; and

* * * *

(d) Overpayment found by Board. If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, or finds that there is a deficiency but that the taxpayer has made an overpayment of tax in respect of such taxable year, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. . . .

* * * *